

# TAX FLASH NEWS

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## TDS provisions are not applicable on the 'provisions for expenditure' since the payee is not identifiable and liability is not ascertained

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Sonata Information Technology Ltd<sup>1</sup> (the taxpayer) dealt with the issue of applicability of Tax Deduction at Source (TDS) on the 'provisions for expenditure' created in the books of account. The Tribunal held that TDS provisions are not applicable on the 'provisions for expenditure' since the taxpayer had not credited the amount to any specific account. The taxpayer does not know the payee and the liability was not ascertained. As per the regular practice, taxpayer identifies the payee in the subsequent Assessment Year (AY) and deducts the relevant tax at source. Accordingly, the disallowance provisions under Section 40(a)(ia) of the Income-tax Act, 1961 are not applicable.

### Facts of the case

The taxpayer is a fully owned subsidiary of an Indian company engaged in the business of various kinds of software related business. During the Assessment Year 2013-14, the taxpayer had created provision for expenses<sup>2</sup> relating to the incomplete project for which taxpayer has already recognised the revenue. These expenses cannot be ascertained due to the reason that the assignment of work is not determined, and the nature of expenses claim may change. The exact nature of expenses will be determined only when the actual expenses or work is assigned in the subsequent assessment year. The Assessing Officer (AO) observed that when the taxpayer credited the expenses and claims the relevant expenses, the disallowance provision under Section 40(a)(ia) is attracted. Further, the taxpayer has reversed the entries in the subsequent year. Therefore, it is clearly a violation of provision of section 40(a)(ia) and accordingly, expenditure was liable to be disallowed.

### Tribunal's decision

The taxpayer had recognised the revenue and at the same time, there were costs which has to be absorbed before recognising the revenue. Those costs are visible and estimated but cannot be quantified i.e. they have identified the nature of expenses to be incurred but cannot decide to whom such work to be assigned. This will be ascertained only when such jobs are assigned. In order to close the books with the matching principles, generally, the taxpayers will create a general provision in their books, and it will be reversed in the subsequent year as and when it is assigned or ascertained. Since the payee is not known and also liability is not ascertained, the taxpayer cannot apply the TDS provisions. This method of accounting is adopted by the taxpayer consistently, therefore the method adopted by the taxpayer is proper.

Since the taxpayer had already declared the revenue without completing the unascertained jobs, without creating the relevant general provision, it will amount to excess charge of income to tax. When the same provision is disallowed, it amounts to double taxation. As per the regular practice, taxpayer identifies the payee in the subsequent AY and deducts the relevant tax at source. Even the payee declares the relevant income in their ROI and pays the relevant taxes. Therefore, there is no loss to the revenue. The Tribunal observed that the taxpayer had followed the accepted method of revenue recognition and to the extent of provision reversed, the taxpayer gets the benefit of deduction.

<sup>1</sup> DCIT v. Sonata Information Technology Ltd (ITA No. 3244 and 3245/Mum/2018) – Taxsutra.com

<sup>2</sup> i.e. in the nature of salary, variable performance pays and other incentives to the work force

Further, the taxpayer does not know the payee or liability is not ascertained and therefore, the provision of Section 40(a)(ia) is not applicable as held in the case of Apollo Tyres Ltd<sup>3</sup>. The Delhi Tribunal in Apollo Tyres remitted the issue back to AO to verify whether payee is not identifiable. In the present case, it is clear from the record that the work was not assigned to anyone. Therefore, it is only a general provision and the taxpayer has not credited to any provision to any specific account. Therefore, TDS provisions would not apply to the taxpayer.

## Our comments

The issue with respect to applicability of TDS provisions on the provisions for expenditure has been a matter of debate before the Courts/Tribunal.

Some of the Courts/Tribunal<sup>4</sup> have held that mere passing of book entries, which have subsequently been reversed, would not give rise to an obligation to deduct tax at source. No income had accrued, arisen or deemed to have accrued or arisen, which is chargeable to tax in the hands of a payee. The Mumbai Tribunal in the case of Alliance Media & Entertainment Ltd.<sup>5</sup> held that the taxpayer had no liability to deduct tax in respect of provision made in the books of accounts since the payees are not identifiable at the time of making of the provision, no statutory obligation was cast upon the taxpayer to deduct tax at source.

On the other hand, the Bangalore Tribunal in the case of IBM India (P.) Ltd.<sup>6</sup> held that the taxpayer would be liable to deduct tax on provision for expenditure created in books of accounts.

The Mumbai Tribunal in the present case has held that TDS provisions are not applicable on the provisions for expenditure since the taxpayer had not credited the amount to any specific account. The taxpayer does not know the payee and liability was not ascertained. Accordingly, the disallowance under Section 40(a)(ia) is not applicable.



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<sup>3</sup> Apollo Tyres Ltd. v. DCIT [2017] 78 taxmann.com 195 (Del)

<sup>4</sup> DIT v. Ericsson Communications Ltd. [2015] 61 taxmann.com 117 (Del), Karnataka Power Transmission Corporation Limited v. DCIT (ITA Nos.750 and 758-759/2009) (Kar)

<sup>5</sup> Alliance Media & Entertainment Ltd. v. ITO [2017] 79 taxmann.com 114 (Mum)

<sup>6</sup> IBM India (P.) Ltd. v. ITO [2015] 174 TTJ 622 (Bang)

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